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VANTUS ENERGY

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November 5, 1996

Arizona Corporation Commission
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Arizona Corporation Commission
Utilities Division
Docket Control
1200 West Washington
Phoenix, AZ 85007

Re: In The Matter Of The Competition In The Provision Of Electric Services Throughout The State Of Arizona, Docket No. U-0000-94-165

Dear Madam:

Enclosed for filing in the above-referenced Docket are original and 10 copies of Comments of Vantus Energy Corporation and Vantus Power Services On Decision No. 59870 Relating To Proposed Rules On Retail Electric Competition. These Comments are being submitted in accordance with the Commission's October 11, 1996 Procedural Order. Please file-stamp and return the extra copy to us in the enclosed addressed envelope.

Please ensure that my name as attorney of record for Vantus Energy Corporation/Vantus Power Services ("Vantus") is added to the service list for all filings and orders made or issued in this Docket. It is the intention of Vantus to appear and comment at the December 2, 1996 public comment hearing ordered in the October 11, 1996 Procedural Order. I would appreciate your advising me if there are any further steps which Vantus must take to become a full party to this proceeding.

Thank you for your attention to this matter.

Douglas A. Oglesby
Counsel

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Fax: 415-217-6473

353 Sacramento Street - Suite 1900 - San Francisco, California - 94111 A PG&E Company

Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA	)))	DOCKET NO. U-0000-94-165

COMMENTS OF VANTUS ENERGY CORPORATION AND VANTUS POWER SERVICES ON DECISION NO. 59870 RELATING TO PROPOSED RULES ON RETAIL ELECTRIC COMPETITION

Date: November 7, 1996

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BEFORE THE ARIZONA CORPORATION COMMISSION

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Vantus Energy Corporation ("Vantus Energy") and Vantus Power Services ("VPS;" Vantus Energy and VPS will be referred to collectively as "Vantus") submit these comments in accordance with the October 11, 1996 Procedural Order issued in this Docket. These comments address the proposed Rules R14-2-1601 through R14-2-1616 relating to Retail Electric Competition forwarded to the Secretary of State for Notice of Proposed Rulemaking pursuant to Decision 59870 issued October 10, 1996.

I
INTRODUCTION

Vantus markets customized, total energy solutions, including energy and facilities management services, power quality services, and gas and electric commodities principally to large energy consumers. Vantus Energy is an indirect, wholly-owned subsidiary of Pacific Gas and Electric Company ("PG&E"). PG&E, headquartered in San Francisco, California, provides retail gas and electric energy services in Northern and Central California. VPS, a direct, wholly-owned subsidiary of Vantus Energy, is the energy commodity marketing arm of Vantus Energy. Vantus Energy has recently established a regional sales office in Phoenix, Arizona, but does not own any electric generation,

transmission or distribution assets in Arizona (or anywhere else) and does not provide any retail electric or gas commodity services in Arizona. Vantus has a keen interest in this Rulemaking. Vantus is actively marketing non-commodity, value-added products and services to large energy consumers in Arizona, and with the advent of retail electric competition plans to market electricity as well.

Unfortunately, the proposed rules will not achieve retail electric competition. This failure means that Arizona consumers will not enjoy the benefits promised by a competitive retail market. Rather than removing regulatory barriers to competition, the proposed rules instead impose on non-utility electric marketers and service providers the same burdensome regulatory regime to which franchised, monopoly electric utilities are subjected. There simply is no public policy reason to require a non-utility marketer to go through a full blown certificate proceeding in which it must divulge a wide range of competitively-sensitive information, to file tariffs with rate caps and service terms and conditions, and otherwise to adhere to the same rules governing billing, service complaints, and reporting as the franchised utilities are required to follow. Competition is achieved by reducing, not expanding, regulation. In contrast, the Federal Energy Regulatory Commission's ("FERC") oversight of competitive wholesale electric markets is an excellent model of the appropriate balance between the regulator's legislative responsibility to protect the public interest and the removal of regulatory barriers to competition.

If this Commission truly desires to foster the development of retail competition for the benefit of consumers, if should facilitate the entry of non-traditional electric service providers into the Arizona markets and the ability of consumers to access those providers. The proposed rules fail to achieve those twin goals.

II
ELECTRIC MARKETERS SHOULD NOT BE SUBJECTED TO THE FULL PANOPLY OF REGULATORY BURDENS IMPOSED ON FRANCHISED UTILITIES

A. The Proposed Rules Subject A Marketer To Monopoly Utility-Style Regulation.

The proposed rules inappropriately subject an Electric Service Provider ("ESP") like Vantus to onerous certificate, tariff, and other requirements typically associated with the traditional regulation of monopoly, franchised utilities. Such requirements are antithetical to the development of competitive markets.

The historic purpose of economic regulation of natural monopolies such as electric utilities was to impose a surrogate for the discipline of competition, which by definition did not exist, in order to prevent exploitation of consumers. Economic regulation of natural monopoly utilities is premised on a regulatory compact under which the utility was granted a monopoly right to serve all customers in a geographic area, in exchange for which it undertook an obligation to serve all those customers in the area who demanded service and subjected itself to a regulated rate of return which afforded an opportunity to earn a reasonable profit. Certificates of convenience and necessity were required in order to assess the utility's competence to provide monopoly service and, once granted, to protect the utility's franchise and prevent competition among natural monopolies which would be destructive of the public interest. Tariffs were required in order to provide the public with notice of rates and charges, to permit regulators to determine if rates were just and reasonable, and to prevent rate discrimination among utility customers.

As the entry barriers (e.g., economies of scale) which created natural monopolies break down and competitive forces develop, however, the role of economic regulation must change. In this changing environment, the proper role of regulation must become one of removing regulatory barriers to competition while maintaining sufficient oversight

to ensure that markets are workably competitive and the public interest is protected. A delicate balance must be struck which establishes a level of regulatory oversight that on the one hand will not impede the development of competitive markets but on the other hand will permit regulators to monitor those markets and detect and prevent abuses. The proposed rules fail to strike that balance. The inevitable result will be that competitive markets will not fully develop in Arizona. The losers will be Arizona consumers.

The most onerous regulatory burdens relate to the requirements that an ESP obtain a Certificate of Convenience and Necessity and file tariffs.

1. The informational requirements to obtain a Certificate of Convenience and Necessity ("CNN") are unnecessary to protect consumers and are detrimental to competition. The rules require an ESP to obtain a CNN. In order to do so, it must submit a broad range of information, including a description of services, a tariff for each service, a description of technical competence, evidence of financial capability, and "such other information as the Commission or Staff may request." The rules permit the Commission to deny the CNN if the ESP does not possess adequate financial and technical capability or does not post a bond.

These CNN requirements are unnecessary to protect consumers. None of the reasons which made a CNN necessary under a regulated regime applies in competitive markets. An ESP will not be seeking a monopoly franchise with a captive customer base and concomitantly will not be undertaking an obligation to provide electric service to all customers in a geographic area. Moreover, while a primary purpose of the CNN was to protect customers from competition among natural monopolies, the purpose of this Rulemaking is to bring competition to consumers. Finally, it is unnecessary to assess the technical/operational competence of a marketer because (i) marketers typically do not own or operate electric plant, and (ii) consumers will not only have recourse to all the remedies traditionally available in competitive markets (e.g., civil suit, withholding their business),

but will also have available the enforcement mechanisms of this Commission and at least in the first few years the safety net of taking service from the regulated franchised utility.

The CNN requirement is bad for competition. The best that can be said about the CNN rules is they create uncertainty, and uncertainty is anathema to competitive markets. But more likely is that many potential ESPs will simply not enter the Arizona market because they will not want to subject themselves to a full-blown certificate proceeding, resulting in fewer competitive options for Arizona consumers.

The transaction costs, delay and uncertainty associated with regulatory proceedings are well known; imposing those burdens on the private sector should be justified only for compelling public policy reasons. Yet this Commission has advanced no public interest justification for burdening otherwise unregulated, non-utility service providers with those costs through a certification proceeding. But even worse than the costs of the CNN proceeding are its information requirements. The proposed rules require a marketer to submit, at a minimum, information describing the electric services it will offer, describing its technical ability to obtain and deliver those services and all other services it proposes to provide, and to provide documentation of its financial capability including financial statements and financial forecasts. Unregulated businesses operating in a competitive environment, such as non-utility marketers like Vantus, treat such information as confidential and proprietary, and go to great lengths to avoid disclosing it. Worse yet, the proposed rules also authorize both the Commission and its Staff to *obtain any other information they want, without any restrictions.* This is a fishing license, exposing the marketer to unlimited demands for information which has no bearing on the protection of consumers, but which may be of great interest to the marketer's competitors.

Vantus recognizes that under Arizona law a public service corporation may not commence "service" without first obtaining a CNN from this Commission. A.R.S. § 40-281. However, this Commission has considerable discretion in administering this requirement. This Commission should tailor the CNN application requirements to the type

of entity applying and to its public policy objective. We submit that this Commission is not required to regulate entities having no utility assets in Arizona, no captive customers, and undertaking no obligation to serve in the same way it regulates its jurisdictional utilities. Issuance of a CNN is justified if the Commission finds that the marketer will not exercise market power, and the Commission's investigative and enforcement capabilities are available to prevent and detect market abuses.

2. Tariffs As Contemplated By The Rules Are Incompatible With Competitive Service Offerings. The rules require each ESP to file tariffs in support of its CNN application and to maintain tariffs on file describing its competitively-offered services. These tariffs must set forth the maximum rates for the services, and the terms and conditions under which the service will be offered. The services may not be provided until the Commission has approved the tariffs. Changes in maximum rates must also be filed and will not become effective until approved by the Commission. These procedures will effectively kill retail electric competition in Arizona.

Requiring a marketer to file a tariff is not necessarily, in and of itself, incompatible with competitive markets. But it is anticompetitive to require that the tariffs set forth the maximum rates and the terms and conditions of each service offered. Nothing in Arizona law compels this Commission to impose such a requirement on non-utility providers of competitive services and to do so is bad public policy. Again, the approach taken by FERC under organic legislation not unlike this Commission's provides a model on how to balance regulatory oversight responsibility against the dynamic characteristics of competitive markets. Section 205 of the Federal Power Act ("FPA") (16 USC § 824d) requires FERC to determine the justness and reasonableness of rates for the wholesale sale of power and the seller to maintain those rates on file. The FPA also prohibits a wholesaler of power from unduly discriminating among similarly-situated customers. FPA § 206(a) [16 USC § 824e(a)]. Therefore, under the FPA an electric power marketer like VPS must submit a tariff to FERC in order to obtain authority to sell power at wholesale at market prices and to maintain that tariff on file. But there the similarity between

FERC's process and this Commission's proposed rules ends. FERC does not require tariffs to contain rate caps or terms and conditions of service. Instead, upon finding that the marketer does not exercise market power (a pro forma finding where the marketer does not own or is not affiliated with electric generation or transmission assets), FERC accepts, with no substantive review, tariffs that merely state that rates, terms and conditions of electric service will be "established by agreement between the purchaser and [marketer]." Consequently, FERC-approved marketing tariffs are only half a page long. A copy of VPS' FERC-approved tariff is attached. FERC's approach permits the service provider and the customer to agree on price, terms and conditions reflecting market conditions and the service's value to the customer at the time the contract is negotiated.

The problem with setting forth the maximum rates in the tariff is that in competitive markets it is not possible for the supplier to know quantitatively what the maximum price will be at any given time—the maximum price will, by definition, be the market clearing price, which may vary on an hourly, daily, weekly, monthly or yearly basis, depending on a variety of factors In fact, spot electricity prices are especially volatile. The service provider and customer must be allowed to negotiate an agreement tailored to meet the needs of both at the time the contract is negotiated.

Presumably, the Commission contemplates a rate cap which is quantified according to some ostensibly rational method and which may, from time to time, be changed. This necessarily means that, depending on market conditions at any particular time, the cap may be less than or greater than the market-clearing price, and therefor at times transactions under the tariff cannot not take place. How will a marketer know what the appropriate tariff cap should be? Must it forecast the highest market-clearing price? What will that be? Must the rate be cost-based? What will a marketer without generation use for costs? How will a marketer forecast what its portfolio, and therefore its costs, will be at any given time? More to the point, what relevance do costs have in competitive markets where price is determined by the service's value to the customer, not the service's costs to the seller? Cost-based rates are appropriate only when markets are not competitive and

consumers require protection from monopoly prices. Purchasers and seller must have the flexibility to respond to rapidly-changing market conditions. Rate caps are a strait jacket on a competitive market.

Nor are rate caps and service terms and conditions necessary to ensure that rates are just and reasonable or to monitor the possible exercise of market power. FERC, for example, holds that its filing and rate review requirements are fully satisfied by requiring that power marketers file quarterly reports summarizing wholesale transactions. According to FERC, "[t]he requirement that marketers file quarterly reports detailing the purchase and sale transactions undertaken in the prior quarter is necessary to ensure that contracts relating to rates and services are on file, as required by section 205(c) of the FPA . . . and to allow the Commission to evaluate the reasonableness of the charges and to provide for ongoing monitoring of the marketer's ability to exercise market power." Heartland Energy Services, Inc., 68 FERC ¶ 61,437 (1994) at 62,065-66. Similarly, the reporting requirements imposed by proposed rule R14-2-1614 could be deemed by this Commission to satisfy its rate review and monitoring requirements, obviating any perceived need to require tariffs to contain substantive rates, terms and conditions.

Moreover, the traditional function of tariffs of preventing undue discrimination is unnecessary in competitive markets. The prohibition against discrimination has its roots in monopoly service where rates are cost-based. In competitive markets, the price is based on the service's value to the customer, not the supplier's costs to provide the service, so cost discrimination is simply no longer a relevant concept.

Importantly, these tariff requirements are not mandated by Arizona law. The Arizona Constitution requires only this Commission to "prescribe just and reasonable rates and charges to be made and collected by public service corporations, [and] make reasonable rules, regulations, and orders, by which such corporations shall be governed in the transaction of business within the State . . . ." A.R.S. Const. Art. 15, § 3. Neither the Arizona Constitution nor implementing statutes requires tariffs, much less mandates what

those tariffs must contain. So long as this Commission is able to find that rates will be just and reasonable, its Constitutional obligation is satisfied. We respectfully submit that a finding that an ESP does not exercise market power will enable this Commission to conclude that negotiated rates are just and reasonable.

At bottom, a rule which requires tariffs to contain a quantified rate cap and terms and conditions of service which must be approved before transactions can take place is flatly incompatible with a competitive market. If this Commission is unconvinced that a workably competitive market will develop by permitting retail consumers to access alternative power supplies, it should continue with the traditional regulatory regime—franchised utilities with an obligation to serve at cost-based rates-- and not pay lip service to retail competition. On the other hand, if it believes in competition, then it must let the competitive market develop, without regulating power marketers as if they were traditional utilities.

B. Public Policy Mandates and Arizona Law Permits Light-Handed Regulation Of Suppliers In Competitive Markets.

There are no public policy reasons to regulate ESPs on the same basis as this Commission regulates traditional public service corporations. Indeed, Arizona judicial precedent recognizes a presumption against the exercise of regulatory authority, and establishes that regulation is appropriate only when necessary to protect the public due to great disparity in bargaining power and where a fair price cannot be assured without governmental intervention. As the Arizona Court of Appeals recently held,

> [T]he purposes of regulation are to preserve and promote those services which are indispensable to large segments of our population, and to prevent excessive and discriminatory rates and inferior service where the nature of the facilities used in providing the service and the disparity in the relative bargaining power of a utility ratepayer are such as to prevent the ratepayer from demanding a high level of service at a fair price without the assistance of governmental intervention in his behalf. [Southwest Gas Corp. v. Arizona Corp. Commn., 169 Ariz. 279, 818 P.2d 714 (Ariz. Ct. Apps. 1991); see also, Opinion of the Attorney General of Arizona, 21 Op. Atty. Gen. Ariz. 222 (1987), quoting Corp. Commn. V. Cont. Sec. Guards,

5 Ariz. App. 318, 426 P.2d 18 (1967), vacated on other grounds, 103 Ariz. 410, 443 P.2d 406 (1968).]

The fact alone that a power marketer like Vantus may be within the literal definition of a "public service corporation" (A.R.S. Const. Art. 15, §. 2) does not require--or, perhaps, even permit-- this Commission to apply the full panoply of regulatory requirements [1]. As we have discussed above, this Commission's organic legislation confers on this Commission wide latitude to regulate jurisdictional entities. And judicial interpretation of that authority underscores that regulation should be no more onerous than required to protect the public interest.

Nearly fifty years ago the Arizona Supreme Court identified the factors to be assessed in determining whether a particular business enterprise would be considered a public service corporation and thereby be subjected to this Commission's exercise of regulatory power. These factors are also relevant in assessing the degree of regulatory intervention needed to protect the public interest. They are:

1. What the corporation actually does.
2. A dedication to public use.
3. Articles of incorporation, authorization, and purposes.
4. Dealing with the service of a commodity in which the public has been generally held to have an interest.
5. Monopolizing or intending to monopolize the territory with a public service commodity.
6. Acceptance of substantially all requests for service.
7. Service under contracts and reserving the right to discriminate is not always controlling.
8. Actual or potential competition with other corporations whose business is clothes in the public interest. [Natural Gas Serv. Co. v. Serv-Yu Coop., 70 Ariz. 235, 219 P.2d 324 (1950).]

All factors militate in favor of light-handed regulation. An EPS is a marketer of power; it does not own utility assets in Arizona and will not dedicate any facilities to

[1] Where an EPS does not dedicate its property to public use and does not undertake a utility obligation to serve, a substantial question is raised whether the furnishing of electricity in and of itself to individually selected customers is sufficient to deem the EPS a public service corporation subject to regulation. See Ariz. Corp. Commn. v. Nicholson, 108 Ariz. 317, 497 P.2d 815 (1972), in which the Arizona Supreme Court held, "state regulation of private property . . . is wholly dependent upon the dedication of private property to a public use with a public interest." The Court concluded, based on that principle, that the provision of water service by the owner of a mobile trailer park to its residents did not make the owner a public service corporation. See also Southwest Gas Corp. v. Arizona Corp. Commn., 169 Ariz. 279, 818 P.2d 714 (Ariz. Ct. of Apps. 1991).

public use; it will not monopolize or intend to monopolize service in electricity; it will not accept substantially all requests for service; it will serve each of its customers under a separate contract with prices, terms and conditions individually negotiated between them; and it will compete against other public service corporations.

III
CONCLUSION

The Commission's proposed rules will not facilitate the development of competitive retail markets. Nor are the rules necessary to protect the interests of retail customers who desire to access alternative power suppliers.. Instead, the proposed rules, if adopted, are likely to deter participation in the Arizona marketplace by a wide range of suppliers and marketers who will not want to subject themselves to utility-like regulation or be compelled to disclose competitively-sensitive proprietary information as a condition to participating. The rules guiding this Commission's oversight of competitive retail markets must not extend utility-style regulation to non-utility marketers and must be sufficiently flexible to permit service providers and customers to respond quickly to rapidly-changing market conditions. We respectfully submit that the proposed rules are unacceptable and must be substantially revised.

Dated: November 7, 1996

Respectfully submitted,

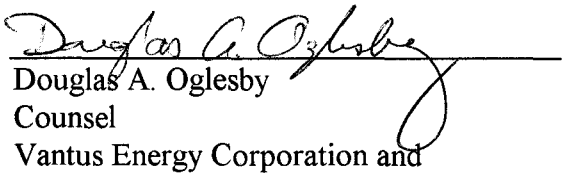

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EXHIBIT 1

Vantus Energy Corporation

Electric Rate Schedule FERC No. 1

1. Availability. Vantus Energy Corporation ("Vantus") makes electric energy and capacity available under this Rate Schedule for sale to any purchaser for resale.

2. Applicability. This Rate Schedule is applicable to all wholesale sales of electric energy or capacity by Vantus not otherwise subject to a particular rate schedule of Vantus.

3. Rates. All sales pursuant to this Rate Schedule shall be at rates established by agreement between the purchaser and Vantus.

4. Other Terms and Conditions. All other terms and conditions shall be established by agreement between the purchaser and Vantus.

5. Prohibited Transactions.

   a. This Rate Schedule is not available for the sale of energy or capacity to Pacific Gas and Electric Company.

   b. This Rate Schedule is not available for the sale of energy or capacity acquired by Vantus from Pacific Gas and Electric Company.

6. Effective Date. This Rate Schedule is effective on and after _____, 1995.

CERTIFICATE OF SERVICE BY MAIL

I, Nicole L. Arnelle, certify that the following information is true and correct:

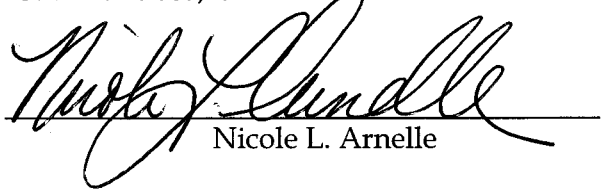
I am a citizen of the United States, more than eighteen years old and not a party to this action. My place of employment and business address is Vantus Energy Corporation 353 Sacramento Street, Suite 1900, San Francisco, CA 94111.

On November 7, 1996, I served the "Comments of Vantus Energy Corporation and Vantus Power Services on Decision No. 59870 Relating to Proposed Rules on Retail Electric Competition," dated November 7, 1996, to all parties to Docket No. U-0000-94-154 by placing true copies thereof in envelopes addressed to the parties shown on the official services list, which envelopes, with postage thereon fully prepaid, I then sealed and deposited in a mailbox regularly maintained by the United States Government in the City and County of San Francisco, State of California.

Executed on November 7, 1996, at San Francisco, California.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Vantus Energy Corporation
353 Sacramento Street, Suite 1900
San Francisco, CA 94111



Nicole L. Arnelle